

The Practicalities of Handling a Fraud Case

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In this economic climate, with fraud on the rise, the author provides a practical assessment of strategies to consider from the investigation of a fraud claim, through framing resulting litigation. Although there are many practical considerations that must be taken into account every time a fraud claim is brought, underlying all of them ought to be the issues of practicality, recoverability and cost.

Times are bad. People are being ripped off every day. Fraud is rampant. So what should an attorney do when contacted by a client who is the victim of a fraud?

This article provides a practical, experience-based assessment of strategies to consider from the investigation of a fraud claim, through framing resulting litigation. Numerous issues should be considered in bringing litigation, and hopefully, maximizing a client's recovery. This "nuts and bolts" review does not discuss the substance of any particular state or federal statute, nor does it analyze any controlling precedent. Rather, the concepts discussed herein apply in any state and circumstance where fraud has surfaced.

THE INVESTIGATION

Usually, what looks like a fraud and smells like a fraud, is in fact, a fraud. Sometimes the fraud is plainly evident, such as in certain equipment lease transactions where a leasing company funds a portfolio of forged equipment leases, with phony lessees. Perhaps most often, fraud involves a false representation in a contract or document that is so blatantly false that there is no doubt that it was intended as a misrepresentation, especially when the financial side of the

transaction crashes. However, sometimes fraud is not facially obvious and requires serious investigation to piece the transaction together, and proof that it was in fact fraudulent, as opposed to an innocent mistake.

Review the Facts

The responsible professional must first analytically review the facts, without any preconceived notions of fraud liability. Not only are allegations of fraud extremely serious and personally damaging, but since there is a more significant cost in pursuing fraud claims than breach of contract or other types of actions, getting it right at the outset is essential. Simultaneously, understanding the financial loss suffered is critical for two reasons: collectability and cost of collection.

For instance, good business sense says that even with a deep-pocket target defendant, it may not make financial sense to pursue a fraud claim on a \$100,000 loss, if alternative claims or remedies can coerce a recovery with less expense than suing for fraud. On the other hand, there could be a multi-million dollar loss with clear liability but no deep-pocket defendant, so the prospects of collection are dim. Right now, there are plenty of sophisticated litigators who have told Bernie Madoff investors they could pay significant

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attorneys fees to sue Madoff (and others), without assuring a recovery. Good money should not be thrown after bad.

Reconciling the Client's Objectives with Collection Costs and the Ability to Recover

While it is true that every case and defendant is different, do not lose sight of the client's objective, which is what ultimately must guide decision-making. Does the client/victim prefer to punish the bad actor, or to recover a loss? With the exception of the fabulously wealthy victims, almost always the objective is to get back the missing money. Assuming so, it means the analysis of collectability and cost of collection must be made at the outset, before one goes too far down the road on lengthy, pricey litigation. Thus, if there are doubts about collectability, or the client does not have the financial staying power through trial, rather than suing a defendant for fraud when there are strong, less expensive claims, the faster and cheaper way to judgment should be pursued.

Of course, the situation frequently exists where a large fraud occurs and the stolen money is recoverable and/or the defendant is collectible. Assuming the experienced fraud prosecutor has conducted his pre-filing analysis, is confident of victory and understands how to gain leverage in a lawsuit, a fraud victory may result in an award of punitive or treble damages, including sometimes, statutory attorneys fees. Naturally, the client needs to be fully advised of all options. Since recovering money remains the object of the legal exercise, if a more simple lawsuit can get to that money faster and cheaper, there is nothing wrong with disregarding the cost and complexities that go with bringing a fraud case. Notwithstanding, even given the cost issues, psychologically many fraud victims, and especially in large frauds, often wish to proceed with bringing a fraud claim, even when properly counseled about other pleading options. In fact, they feel a need to bring these claims to validate that they are victims.

Determining Collectability

In terms of financial investigation to determine collectability, how does one find reliable information for review and sufficient analysis?

Generally, financial privacy laws preclude a detailed investigation into a person's monetary type assets, such as bank accounts or marketable securities, so absent good luck or terrific sleuthing, reliable information about these assets is not attainable. That does not mean, however, that a sophisticated financial investigation of a fraud target cannot reap meaningful information.

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A search of public records can provide great detail about certain assets, which may enable a professional to logically infer whether or not a person is collectable. Title records in the county where the target resides will list recorded deeds to real property owned by the person, as well as corresponding mortgages. Reviewing those documents plus a call to a local real estate broker or Internet search for similar online listings, ought to provide a ballpark understanding as to the amount of equity in the property. Consideration must be given to where the property is located. Florida, for instance, has an unlimited homestead exemption, protecting a broadly construed homestead from the reach of creditors.

Each state's Division of Corporations provides online access that identifies the names of any form of registered business entity that cross-references to a target's name. Corporate name searches may lead to finding more than just other companies with whom the target is affiliated. Often, running new found corporate names through the county recorder's records may yield real properties indirectly owned by the target defendant. Further, state automobile, boat and federal aircraft title records can be searched. Sophisticated computer searches can pull a target's full history throughout the nation, and may show out of state assets. It is prudent to check the records of locales where a target spent many years and may still visit, such as a hometown. Perhaps the target vacations in

the same place regularly, which might divulge a second home. Interviewing known colleagues or friends may lead to valuable information. Even hiring an investigator to sift through discarded trash which carries no expectation of privacy, or to follow the person, could yield results.

In conducting your pre-filing assets analysis, note that some states, again such as Florida, do not allow a joint tenancy or tenancy by the entirety to be severed or partitioned, when it comes to satisfying a judgment through post-judgment procedures. A guilty defendant could conceivably have millions in assets, but if he lives in such a state, and the property is titled jointly, it may be exempt from levy and execution.

Additionally, once a case is filed and discovery ensues, it is fair game to “follow the money.” Do not be surprised if the defendant attempts to obtain a protective order, arguing the plaintiff is engaged in pre-judgment asset discovery. It should not be too hard to explain to a judge why review of the defendant’s financial documents is important to a substantive issue in the case; perhaps tracing the participation of co-conspirators or aiders and abettors. As discussed below, if enough money is located, the possibility of bringing a pre-judgment attachment to seize those funds should be explored.

What if there are numerous outstanding judgments against the target, yet he is living a luxurious life? This would suggest money is parked somewhere, so an asset search of a spouse, children, parents, or other family members who may be the recipients of fraudulent conveyances, is appropriate.

Once a lawsuit begins, the advantage in asset investigation tilts to the plaintiff. Discovery rules are broad, and requests for production of documents and/or subpoenas can often lead to a plaintiff being able to review a defendant’s tax returns, full banking and financial records, computer files, phone records, and countless other documents that suggest places where a defendant’s money is located. The most obvious instruction remains “follow the money.”

A great technique for putting pressure on a defendant and pleasing a client is utilizing pre-judgment remedies. It is really simple: bad actors do not like having their property taken from them involuntarily. It gets their attention and catches them off guard. It makes them realize that they are dealing with serious people who will pursue them aggressively. Each

dollar seized is a dollar that remains secured for the benefit of the plaintiff until conclusion of the case, is not available for defense costs, cannot be squandered away, sheltered, or fraudulently transferred. Pre-judgment remedies exist in every state, though the procedural aspects of these laws vary to a degree, on items such as amount of bond and elements to support granting the applicable writ.

CASE STRATEGY ISSUES

While the bad news is that your client is the victim of a fraud, often the good news is that the fraud was not conducted by an individual, which increases the number of parties who can contribute cash to making the client whole. Usually, large frauds are committed by a good sized group, depending on the complexity of the scheme. Understanding that layers of persons are involved in the fraud provides an opportunity to seek recovery from all culpable parties. Moreover, strategically, having a group of culpable defendants involved, enables counsel to utilize a divide and conquer strategy that pits one defendant against another.

Divide and Conquer

Suing every person who legitimately should be sued creates the opportunity to both collect money from lower rung bad actors, while also extracting testimony from those bit players against the main perpetrators of the fraud. The defendants at the top of the fraud pyramid may have the stomach and financial wherewithal to fight, but often those at the bottom want no part of being tied in to an extensive and expensive fraud action, and they often do what they have to early on, in order to alleviate further liability.

A strategy to deal with people who may have valuable information and do not want to be in the case long term, is to convince them that if they disclose the truth under oath so that their testimony can be used against the other bad actors who have committed the fraud, they can be dismissed from the action for a minimal cost. This requires counsel to know exactly what the person has done wrong, so they can be confronted with it, plus an economic analysis of how much money they have, weighed against the cost of defense. The settlement agreement with these defendants must require their voluntary attendance at trial.

There can be a wide net of target defendants. Larger frauds often involve bribery, kickbacks or excessive compensation payments in order to get third parties to turn a blind eye to, or even directly manipulate data that causes the fraud. Often, this third party involvement gives the underlying transaction a vestige of credibility, but it does make these people secondarily liable. These circumstances seem to arise most often in Ponzi schemes or large securities frauds.

Professionals as Targets

Depending on the nature of the fraud, attorneys and accountants may be liable. Sometimes this happens willingly and sometimes through poor judgment, but professionals have long been targets in fraud cases. Any professional who has prepared incorrect financial or transactional documents during the fraud which the victim reviewed, relied upon and induced the transaction in question, is at risk for being sued. Worse, those professionals who actively promoted the transaction or were at the forefront while the scheme was being perpetrated have even greater risk of exposure. Investigating professionals must be done at the outset of retention because there are usually shorter statute of limitations periods for bringing malpractice actions, assuming one can plead privity or a related claim (a detailed discussion of which is beyond the scope of this article).

A critical element to understand at the outset of proceeding against any professional is the availability of insurance. Having an errors and omissions policy is always a potential source of recovery, notwithstanding attaching the unencumbered assets of the professional and his firm. A complaint that sues professionals, however, must be carefully pled because most professionals' policies contain an exclusion from coverage for fraudulent conduct. Assuming that to be the case, because it is the norm, not the exception, plaintiff's counsel will have to be creative in stating claims and allegations so that the insurer does not deny coverage to the professional upon the Complaint being filed. Some claims to consider, depending on the facts and applicable state law, include negligence, third party beneficiary, promissory estoppel, or breach of fiduciary duty.

To be sure, this article does not discuss the techni-

calities of secondary liability under any state or federal law, including under a federal securities analysis based on Supreme Court precedent of recent times. However, numerous articles have been, and will be, devoted to that topic alone and the advance sheets shed new light on these issues every week. Certainly part of the due diligence in proceeding against professionals encompasses having a thorough understanding of co-conspirator, aider and abettor and secondary liability. Relying on preconceived notions of such liability, and even one-year old law might be a recipe for pleading disaster in responding to a motion to dismiss.

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Assessing Claims Options

Along the lines of understanding secondary liability, thought ought to be given to moving away from bringing federal securities claims, given recent case developments. In a securities case with typical federal Rule 10b-5 claims, why not ignore them and eliminate the pleading difficulties, and go with claims more simple to plead? In probably every state, common law fraud can be pled against most primary and secondarily liable persons. There are also state securities Blue Sky claims that are often less pleading restrictive than federal securities claims, depending on the state. Keep in mind the objective — that is to obtain the maximum recovery for the client, cost effectively. Few cases actually get to trial. Thus, if counsel can alleviate case expense and still get a good result by avoiding the pleading and proof issues on more difficult claims, then that strategy must be considered.

Along these lines, in reality, what does a RICO claim actually achieve? Virtually all federal courts' local rules now require the filing of detailed RICO Case Statements and RICO complaints are strictly scruti-

nized. It seems that few actually survive the motion process, so given an understanding that counsel can achieve the same goal without the additional time and expense of RICO, why even go there in the first place? Also, some states have their own less restrictive RICO statutes, civil theft statutes or even broadly construed Consumer Deceptive Trade Practices Acts that establish good claims and provide double or triple damage awards, and often attorney's fees.

Receiverships

Another strategy to consider, particularly in larger fraud cases, is seeking the appointment of a receiver over an entity that orchestrated the fraud. A receivership should be contemplated where records must be immediately sequestered and assets of the entity must be preserved. Receiverships are expensive and someone has to pay for them, usually the plaintiffs. Proceeding with a receivership always requires a cost-benefit analysis, but removing the bad actors from the entity that was the instrumentality of the fraud and putting it into the hands of a reliable, time-tested receiver with fraud and accounting experience, may be the best way to go. As is commonly known, in very large securities frauds, often the Securities and Exchange Commission steps in and gets a receiver appointed for the entity.

Choosing a Forum

Consistent with deciding who to sue and what claims to bring, is determining what court the case should be filed in? This decision is going to always be a local call, based on a variety of factors. Without questioning the quality of any state bench, it seems to be generally recognized that federal judges are across the board considered to be superb. Many litigators have a preference to be in federal court just for that reason alone, putting aside the issue as to whether or not diversity or federal question jurisdiction exists.

What is the state of the docket in your respective venue? Are the federal courts tied up with a huge criminal docket that has preference given the Speedy Trial Act? On the other hand, given the economy, is your state judge deluged with foreclosures, which

leaves little time for the handling of the rest of the case docket? Further, many state budgets are currently extremely tight, and it is well-documented that the state court judicial systems across the country have faced serious cutbacks.

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BEYOND THE CIVIL SUIT: CRIMINAL FRAUD

The question also arises on what to do when the fraud rises to the level of criminal activity, which is usually the case. Counsel must understand the client's objective. Is it more important for the client to get repaid or to punish the wrongdoers? Once a criminal referral has been made to the authorities and an investigation begins, there is a substantial likelihood that the fraudulent actor will have to devote financial resources to defending himself at the criminal proceeding, rather than the client's case. It also raises problems in terms of access to proof if prosecutors take custody of documents necessary to prove a lawsuit. Last, is the double-edged sword of the defendant taking the Fifth Amendment. Counsel may wish to obtain the general presumption that exists in civil cases when a defendant invokes the Fifth Amendment, that the testimony if provided would be negative to the witness' interest. Or, it may be better to obtain full testimony. Be aware that in certain states, taking the Fifth Amendment and the presumption that goes with it, can lead to similar presumptive findings being made against co-conspirators.

CONCLUSION

In sum, there are many practical considerations that must be taken into account every time a fraud claim is brought. Underlying all of them ought to be the issues of practicality, recoverability and cost.